D 71/989

FET

Foreign Economic Trends and Their Implications for the United States

JUNE 1989

DOMINICAN REPUBLIC

FET 89-63
Frequency: Annual
Supersedes: 88-109

PREPARED BY
AMERICAN EMBASSY SANTO DOMINGO

U.S. DEPARTMENT OF COMMERCE
International Trade Administration
Washington, D.C. 20230

Available by subscription from the Superintendent of Documents, GPO, Washington, D.C. 20402. Annual subscription, $55.00. Foreign mailing $13.75 additional. Single copies, $1.00, available from Publications Sales Branch, Room 1617, U.S. Department of Commerce, Washington, D.C. 20230.

C 61.11:

READEX FICHE best copy available

KEY ECONOMIC INDICATORS
In millions of U.S. dollars unless noted

	1986	1987	1988 Prelim	1989 Projected
Domestic Economy				
Population (millions)	6.4	6.6	6.7	6.9
Population growth (%)	2.5	2.4	2.4	2.3
GDP in current peso prices	17501	21745	31407	38290
% change	26.2	24.3	44.4	22.0
U.S. GDP in constant 1988 U.S. prices	4811	5045	5278	5222
U.S. GDP Per Capita const. 1988 U.S. prices	752	764	787	757
Real GDP Growth	2.8	8.1	0.9(1)	0.6
Consumer price index % change	6.5	25.0	57.6	62.0
Production and Employment				
Labor Force (1,000's)	2618	2710	2805	2904
Unemployment (avg. % per year)	28.7	26.3	28.6	29.6
Public Sector Deficit as % of GDP	6.0	5.0	4.3	4.0
Balance of Payments				
Exports (FOB) 2/	722	723	894	950
Import (FOB) 2/	1266	1550	1608	1660
Trade Balance	-544	-827	-714	-710
Free Zone Exports 3/	246	325	517	650
Current Account Balance (cash basis)	-121	-293	-128	-135
Foreign Direct Investment (new)	50	89	106	108
Foreign Debt (year end)	3772	3898	4060	4150
Debt-service owed (scheduled)	740	770	761	820
Debt-service paid	590	499	583	600
Debt-service ratio as % of goods and service exports	47	38	37	37
Foreign exchange reserves (year end)	429	204	145	90
Gross tourism earnings	506	568	616	640
Average exchange rate for year (RD$_____=US$1.00)	2.88	3.85	5.95	8.60
Foreign Investment				
Total (cumulative)	440	448	457	466
U.S. (cumulative)	202	204	210	216
U.S. share (%)	61	51	45	46
U.S.-D.R. Trade				
(Dominican Government Data) 2/				
U.S. exports to D.R. (FAS)	500	640	695	730
U.S. imports from D.R. (CIF)	538	533	543	616
Trade balance	-74	60	152	114
U.S. share of D.R. exports (%)	75	74	60	62
U.S. share of D.R. imports (%)	39	41	43	44
Free Zone Exports (D.R. to U.S.) 3/	238	323	508	630
(U.S. Government Data) 4/				
U.S. exports to D.R. (FAS)	892	1121	1341	N/A
U.S. imports from D.R. (CIF)	1111	1197	1488	N/A
Trade balance	-219	-76	-147	N/A
U.S. Bilateral Aid				
Economic	99.8	104.8	50.7	56.3
Military	4.5	3.3	0.7	0.7

Principal U.S. exports: textiles, cereals, motor vehicles & parts, appliances
Principal U.S. imports: gold, sugar, garments, ferronickel, cocoa, coffee

1/ Central Bank Statistics
2/ Free zone data not included in Dominican export/import data.
3/ Includes value of goods assembled from U.S. components.
4/ U.S. Government trade data differs from Dominican trade data principally because: 1) U.S. data includes free zone trade; and, 2) Dominican imports and exports tend to be underinvoiced.

Sources: U.S. Government, Dominican Government, World Bank, IMF.

SUMMARY

Economic activity in the Dominican Republic was stagnant in 1988, with an official 0.9 percent real growth rate. Inflation (CPI) soared to 57.6 percent. This follows a 1987 real growth of 8.1 percent and an inflation rate of 25 percent. Respected economists disagree with the Central Bank statistics, claiming that the growth rate was negative 0.2 percent and inflation reached more than 60 percent in 1988.

During 1988 the money supply (M-1) expanded by 49.1 percent. This expansion plus speculation caused a volatile foreign exchange market during the first half of the year. The Central Bank reacted by closing all exchange banks in June and imposing a fixed exchange rate of 6.35 pesos per dollar and full exchange controls on August 1. Under these still effective controls, all incoming dollars must be sold to the Central Bank through the commercial banks and all requests to purchase dollars must be submitted to the Central Bank through commercial banks. In an effort to dampen demand for dollars, the government imposed a ban on luxury imports and vehicles through late April 1989. Overall, the peso depreciated by 24 percent in 1988.

The Dominican Republic kept current on its debt payments to international financial institutions and paid interest on its debt with commercial banks during the year. However, it did not service most of its Paris Club debt. Arrears with Paris Club creditors reached US$388 million in 1988. President Balaguer and the Central Bank Governor continue to pledge to pay all external debt, but "only within the country's means." The Government of the Dominican Republic consults with the International Monetary Fund (IMF), but is wary of negotiating an agreement that would impose or appear to impose onerous economic adjustment conditions on the country.

The Government of the Dominican Republic's development policy targets four main areas: agriculture, mining, tourism, and free zones. Agricultural development continues to lag behind other areas for a variety of reasons, including high inflation, price controls, and high freight rates. While there was substantial growth in the mining sector in 1988, it was due to increases in world prices for ferronickel rather than increased production. Free zone development is expanding rapidly with 17 zones currently in operation. Tourism stands out as the largest foreign exchange earning sector and shows continued potential, having just completed a successful high season and with strong bookings for the low season.

Best new prospects for U.S. exporters are food processing and packaging equipment, and computers and medical equipment. Best

continuing prospects are motor vehicle parts and equipment, textiles, basic foods, agricultural chemicals and equipment, electrical equipment, appliances, and generators.

PART A: CURRENT ECONOMIC SITUATION AND TRENDS

ECONOMIC GROWTH: The Dominican Central Bank reports that the economy grew 0.9 percent in 1988. Nevertheless, some respected economists and bankers estimate that the economy actually shrank. Probably the most important factors affecting the growth rate for 1988 were inflation and a lack of reliable electricity service.

Inflation at the end of 1988 was 57.6 percent over the end of 1987, according to Central Bank statistics. The Dominican Government uses an average inflation figure measured over the year, which according to the Central Bank was 44.5 percent in 1988. However, the generally accepted average inflation figure for 1988 (accepted also by many government officials) is 60 percent.

Electricity availability worsened in 1988 with a 2 percent contraction in this sector. This decline does not even reflect the production losses caused by frequent, unpredictable power outages, brown-outs or surges. It is estimated that less than one-half of the nation's electricity demand is currently being met by the monopoly state-owned electricity corporation.

The communications sector displayed the highest growth rate in 1988 at 16 percent essentially due to expansion of the telephone company. The financial services industry followed with a 10.1 percent growth rate. Expansion in the banking subsector was largely due to the increased amounts of money handled by the banks (caused by a rapidly expanded money supply) and a substantial interest rate spread. Increased valuation of insured properties enhanced growth in the insurance subsector.

Following a 4.3 percent decline in 1987, the government sector grew by 8.4 percent in 1988. The construction sector grew by 7.6 percent in 1988 as President Balaguer continued his huge public capital spending program to build housing, roads, dams, irrigation canals and other projects. Moreover, the private sector continued to invest in new office buildings, apartments, and houses.

The most rapid declines were seen in the mining and industrial sectors. The mining sector declined by 7.7 percent (measured in volume) due to nonproduction of ferronickel during the first 4 months of 1988, although the value of mining exports

increased due to a rise in ferronickel prices on the world market. The 3.4 percent drop in the industrial sector was due to severe electricity supply disruptions and the general slowdown of the economy.

The favorable rate of exchange and competitive wages have continued to boost development of the free zones and tourism. In the free zones, local and foreign-owned companies import semifinished materials, such as cut fabric or electronic components, and assemble the goods for reexport. There are now over 220 companies operating in 17 free zones employing approximately 95,000 workers. This sector's spectacular growth is likely to continue.

The agricultural sector remains stagnant with negative growth of 1.7 percent in 1988. Major investment continues in export-oriented agribusinesses, but the basic food production area remains weak. The government requires that low interest rates be applied to agricultural loans in an attempt to increase investment, but capital is unavailable at the low interest rates. Government price controls contributed to shortages of poultry, rice, and milk in 1988. During 1988 the U.S. sugar quota was increased, and world sugar prices rose. However, sugar remained severely depressed due to labor shortages and unseasonable rains during the harvest period.

While the Central Bank predicts a 3 percent growth rate for 1989, many economists project a minimal real growth rate of 0.5 percent. Communications should remain the largest growth sector.

FOREIGN DEBT: The Dominican Republic, like other Latin American countries, faces a severe foreign debt problem. The country, with a fast growing population of nearly 7 million inhabitants, has accumulated an external debt of over US$4 billion (including interest arrears), the equivalent of about 79 percent of GDP. Approximately 21 percent of external debt is owed to commercial banks, 32 percent to developed country bilateral lenders (Paris Club), 15 percent to other bilateral lenders (including Mexico and Venezuela for oil purchases) and another 29 percent to international financial institutions (including the IMF, the Inter-American Development Bank and the World Bank). The remaining 3 percent is owed to short term suppliers.

A Standby Agreement signed with the IMF in January 1985 allowed the Dominican Government to reschedule much of its debt through April 1986. Since then, the Dominican Government has met payments to the international financial institutions and interest payments to the commercial banks but is not servicing most Paris Club debt. Overall, the Dominican Government external payments arrears in 1988 increased to an estimated US$194 million.

President Balaguer and the Central Bank Governor have pledged to pay the debt, but "only within the country's means." Above all, Dominican authorities have stated that debt-service must not hamper the country's development. Under this policy, the Dominican Government projects actual debt service payments of US$600 million in 1989 (against scheduled service of US$820 million), but has not yet developed a plan to pay arrears.

While government officials have undertaken consultations with the IMF and expressed interest in an enhanced surveillance agreement, the Dominican Republic remains wary of negotiating an agreement that would impose or appear to impose onerous adjustment conditions on the country. Government officials fear that austerity measures would create social and political turmoil, particularly if perceived as imposed as a part of an IMF agreement. The Dominican Government took some measures in 1988 (specifically improved tax and customs collections) that have improved the fiscal balance.

The Central Bank has completed draft guidelines for a debt conversion program. While complete details of the program are not yet publicly available, Central Bank officials are certain that, once approved, the program will be attractive. Some ad hoc transactions have already occurred.

BALANCE OF PAYMENTS: The Dominican Republic's current account situation improved in 1988 due to a 26 percent expansion in exports (primarily ferronickel) with only a 4 percent increase in imports, as well as a more realistic remittance estimate in the transfers section. Imports have been restrained as a result of a 20 percent import exchange commission, an import ban on automobiles and certain "luxury" items, and lower world oil prices. (A May 1989 decree lifted the import restrictions for 1,700 vehicles.) The 1987 current account deficit of US$293 million (cash basis) was reduced to a deficit of US$128 million (cash basis) in 1988. The rescheduling of San Jose Accord oil debt with Venezuela, increased foreign investment, and disbursements by international financial institutions increased the capital account by US$187 million. These improvements, according to Central Bank statistics, leave an overall balance-of-payments surplus in 1988 of US$145 million (cash basis). Most private economists believe the overall balance was substantially less.

Tourism foreign exchange earnings were reported at US$616 million in 1988 and are forecast to increase in 1989 to US$640 million. In 1988, expatriate remittances, from Dominicans living primarily in the United States, are estimated to be US$328 million, an improved estimate over the US$200 million figure used in 1987. The Central Bank forecasts a 1989 current account deficit of US$130 million.

Increased oil prices and the heavy debt-service burden are expected to contribute to an overall balance-of-payments deficit in 1989. Further debt rescheduling and reduced fiscal expansion to cut import demand are essential ingredients to improving the balance-of-payments picture. Under ideal conditions, government officials could expect increased international financial institution loans, increased foreign investment, and implementation of a debt conversion program to reduce the deficit to about 1 percent of GDP.

MONETARY AND FOREIGN EXCHANGE POLICY: During 1988, the money supply (M-1) expanded by 49.1 percent. This followed the 33.9 percent increase in 1987 and the 45.6 percent increase in 1986. Much of this increased liquidity was absorbed by increased Central Bank deposit requirements. The increased money supply resulted from: 1) the Central Bank buying dollars from all sources to pay the foreign debt, yet not receiving the full amount of compensatory pesos from the central government for debt-service payments or petroleum import payments; and 2) large credit and subsidies granted to government enterprises such as the State Sugar Company, Dominican Electricity Company and the state-owned Agricultural Bank.

As a result of speculation and the large increases in the money supply, the value of the peso relative to the dollar dropped quickly. The Central Bank tried several measures to contain the peso's slide but by June 23, 1988 it reached its lowest point of 8 pesos per dollar, a depreciation of 38 percent relative to its value on December 31, 1987.

On August 1, 1988, the Central Bank fixed the exchange rate at 6.35 pesos per dollar and imposed full exchange controls. These controls require that all incoming dollars be sold to the Central Bank through commercial banks and all requests to purchase dollars be channeled to the Central Bank through commercial banks. The official exchange rate is tightly policed and strictly enforced. The result has been a stable official exchange system and a very thin black market offering rates very close to the official rate. As of June 1, 1989, this exchange system remains in effect. For 1988, as an average, the peso devalued 35 percent against the dollar.

President Balaguer and Dominicans generally place a great deal of importance on the value of the peso. Politically, it is seen as a marker of the government's success in managing the economy. It is also crucial to economic growth since it must depreciate in line with relative inflation if growth and

development are to occur. Yet a higher exchange rate quickly translates into higher local prices because, on average, 50 percent of the content of all domestic products are made with imported components. Furthermore, the declining value of the peso is most quickly felt by the poor and the middle class who have fixed peso salaries.

TOURISM: The tourism industry continued its strong growth in 1988. A combination of attractive beaches, friendly people, and a generally favorable exchange rate lured record numbers of foreign tourists (about 700,000), mainly from Canada, the United States, and Italy, with increasing numbers from England, Germany, and Spain. The number of hotel rooms increased from about 12,000 in 1987 to about 16,500 by the end of 1988. The Dominican Republic now has the largest number of hotel rooms in the Caribbean. Projections are for a 15 percent increase in rooms in 1989. Spin-off industries, including tour operators, ground transportation and restaurants, are creating a myriad of opportunities for guides, drivers, hotel personnel, managers and entrepreneurs. As the number of tourists increases, the Dominican Government will have to devote more resources to improving the infrastructure and services made available to this sector.

LABOR: The Dominican Republic has an ample labor supply, with a total work force estimated at 2.9 million. Dominican labor is industrious, cooperative, and easily trainable in basic skills. However, there is a shortage of skilled workers and technicians. The trade union movement, still in its infancy, is highly politicized. It is weak and divided with at least eight competing national confederations. Organized labor represents less than 15 percent of the country's labor force. The country's high unemployment and underemployment (the combined rate exceeds 50 percent of the work force) also tends to diminish the strength of the labor movement. The labor environment has been basically tranquil in 1988 with few serious genuine labor strikes.

However, popular discontent and frustration generated a series of community strikes in rural and urban areas throughout the country in the spring and summer of 1988. The public wage strikes were fueled by sharp increases in the prices of basic necessities, high unemployment, deteriorating public services and demands for an increase in wage levels. In March, the Catholic Church sponsored a series of negotiations among the Dominican Government, private sector, and labor to peacefully address demands. The "Tripartite Talks" produced an agreement

including an increase in the minimum wage from 350 to 500 pesos a month for private sector employees (and to 400 pesos for public employees). While most employees seek a wage hike in 1989 to counteract the sharp rise in inflation, the government has stated it has no plans to authorize an increase in the minimum wage.

POLITICAL SITUATION: After the 1961 assassination of the dictator Rafael Trujillo and several years of political instability culminating in the U.S. military intervention in 1965, the Dominican Republic established a democratic system of four-year presidential elections. Since 1966, six consecutive national elections have been held. During this period, two major political parties, the Social Christian Reformist Party (PRSC) and the Dominican Revolutionary Party (PRD), have dominated Dominican politics. Both parties support a mixed, pluralistic economy and strong, friendly relations with the United States.

Joaquin Balaguer, former president (1966-78) and leader of the PRSC, won the May 1986 election and was inaugurated in August 1986. Since taking office he has embarked upon a populist program of government and has focused his attention on public works.

Internal divisions within the PRD between factions led by Jacobo Majluta and Jose Francisco Pena Gomez contributed to its loss at the polls in 1986. After more than two years of acrimonious clashes, in late 1988 the two factions began a difficult reunification process.

The leftist Dominican Liberation Party (PLD), headed by Juan Bosch, captured 18 percent of the vote in 1986, an improvement of eight points over 1982. The party's improved showing reflected its tight organization and discipline, and an increased loss of confidence in the two leading parties.

The next general elections are scheduled for May 1990. Campaigning started in January 1989 with the principal candidates being President Balaguer (as of yet unannounced), Juan Bosch, and the two PRD rivals, Jacobo Majluta and Jose Francisco Pena Gomez. The Dominican people's perception of how Balaguer is handling the country's economic problems will play a large role in determining the outcome of the elections.

PART B: IMPLICATIONS FOR THE UNITED STATES

The Government of the Dominican Republic welcomes foreign investment. In 1988 foreign investment registered with the Central Bank increased by US$9 million to US$457 million. Forty five percent of this registered investment is from the United States. Because not all foreign investment is registered with the Central Bank, total foreign investment in 1988 was probably substantially higher than officially recorded. Registered foreign investment generally reflects investments under the investment code, seeking to benefit from certain tax exemptions. Overseas Private Investment Corporation (OPIC) insurance, loan guarantees, and equity participation are available for investments made in the Dominican Republic, as are U.S. Trade and Development (TDP) grants for feasibility studies. Joint ventures are required in agribusiness projects with foreign companies limited to 49 percent of equity holdings. Given the complex and often inexact nature of agrarian tenure in the Dominican Republic, it is indeed desirable to have a Dominican partner. In other popular investment areas, such as free zones and hotels, foreign business may wholly own the venture. The desirability of having a local partner will depend on the foreign investor's knowledge of the Dominican Republic's economy, laws, and practices.

FREE ZONES: During 1988 the industrial free zones (IFZ) continued their rapid expansion. This expansion will continue in 1989. At present, there are 17 IFZ's in operation. Another four IFZ's are under construction and should open this year. Several others have been approved for development by the National Council of Industrial Free Zones. U.S. companies which have established operations in the IFZ's include Westinghouse, GTE, Hanes, Baxter Travenol, Warner Lambert and American Airlines.

Total export value from the IFZ's to the United States increased from US$205 million in 1985 to US$508 million in 1988. Ninety-two percent of IFZ exports went to the United States.

IFZ's are attractive to U.S. manufacturers because of the low wage structure (current minimum wage is approximately 57 U.S. cents an hour), a stable and trainable work force, and proximity to the United States. In addition, U.S. programs under the Caribbean Basin Initiative and General System of Preferences benefit the IFZ's. These factors, as well as the Dominican investment incentives, contribute to the rapid growth of the IFZ's. The Dominican Government offers duty-free import of raw materials, equipment, and goods destined for reexport, complete tax exemption for a 12-20 year period, and the option to sell up to 20 percent of production in the domestic market.

TOURISM, AGRIBUSINESS, MINING: Possible incentives for investment in approved tourism projects include a 10-year tax exemption from income and corporate taxes, national and municipal taxes, licenses and fees for public events, and import duties for goods not locally available.

Investment in agribusiness has not taken place as rapidly as investment in IFZ's and tourism, although opportunities exist for investment in fruit, vegetable, and flower production for export. The Santo Domingo-based Joint Agricultural Advisory Committee (JAAC), which assists agricultural investors, has a US$450,000 TDP grant for funding agribusiness feasibility studies.

The Balaguer government has renewed efforts to attract foreign investment in mining. There are known deposits of gold, silver, nickel, bauxite, coal, marble and limestone in the country. Several U.S. mining companies have conducted preliminary exploration and have expressed interest in mining projects.

BEST PROSPECTS FOR U.S. EXPORTERS: U.S. exports account for about 43 percent of total Dominican imports. Additionally, U.S. raw materials are used in the Dominican free zone assembly operations, especially in the apparel and textile industry.

Leading U.S. exports include:

- woven and textile fabrics, and cut textile for apparel assembly
- passenger cars, trucks, chassis and motor parts
- wrapper tobacco
- basic foods, including wheat, corn, vegetable oil, soybeans and soybean oil
- agricultural and construction machinery and equipment
- agricultural chemicals, including fertilizers and pesticides
- electrical articles and equipment
- wood products

Best new product export opportunities include:

- food processing and packaging machinery
- computers (micro and mini)
- medical equipment and supplies
- generators
- small appliances which can undergo simple local assembly (such as installing blades for ceiling fans)

The U.S. and Foreign Commercial Service will sponsor the following trade promotion events in the Dominican Republic during 1989:

May 7-11 -- Reverse Trade Mission to Detroit, Michigan
June 2-4 -- EXPO USA '89
July 16-20 -- Video Catalog Show, Auto Parts and Accessories (Santo Domingo, Puerto Plata, Santiago & La Romana)
August 10-11 -- Pharmaceutical Conference, Production Control and Protection of Patents/Copyrights
August 22-23 -- Video Catalog Show, Packaging and Printing Equipment (same four cities)
September 17-23 -- Tourism Investment and Marketing Mission
September 23-27 -- Catalog Show, Tourism Industry Supplies (same four cities)
December 5-7 -- Video Catalog Show, Food Production Equipment (same four cities)